London predicts January dollar crisis

Reagan can bolster the dollar by ending the Volcker interest-rate hikes instead.

The City of London and the Thatcher government say that the U.S. dollar may be in trouble just in time for Reagan's inauguration.

Federal Reserve Board Chairman Paul Volcker has adopted a British interest-rate policy, but unless the Reagan administration adds to it a Thatcher-style fiscal austerity program, the U.S. dollar is in for an old fashioned currency crisis of the sort which used to plague the British pound sterling, the London *Financial Times* editorialized this week.

In "The Old Duke Emigrates," the monetary policy of the Bank of England is likened to the strategy of the Duke of York, who marched his 10,000 men up, and then down, the hill again: jacking up interest rates and then letting them fall freely.

Britain has learned that this policy by itself will only cause the money supply to grow out of control, encouraging foreigners to dump the currency, the daily says. "The Duke, however, has not died; he simply seems to have moved to New York," they write, for Volcker is still trying to jack rates up only to let them fall, thinking this will encourage investors to buy long-term corporate bonds while rates are still high.

The rate gyrations have instead killed the U.S. bond market, "and dealers talk freely of catching the British disease," the London bankers' paper notes.

This is leading to an explosion in the U.S. money supply, because corporations forced off the bond market are borrowing furiously short term from the banks. "The Fed is tending to find, just as the Bank of England used to, that the harder it squeezes, the faster monetary growth becomes," the *FT* writes. "There is no reason to expect that it will be any easier for Americans to escape from this impasse."

British Chancellor of the Exchequer Sir Geoffrey Howe, in a speech this week, also noted that the pound will continue strong against the dollar no matter how high Volcker raises rates. "Now that U.S. rates have risen and ours fallen without any major impact on sterling, it is very hard to argue" that sterling is headed anywhere but up against the dollar, he said.

By the time of Reagan's inauguration, the *Financial Times* writes, Reagan will be able to stave off a dollar crunch only by showing he is serious about fighting inflation. This means endorsing Volcker and also making slashes across the board in the U.S. budget, including cuts in military spending, pay freezes, and abandonment of Reagan's much-publicized plans for a major tax cut.

The pressure on the dollar "is posing some nasty problems . . . for President-elect Reagan some weeks ahead of his accession, as Mr. Volcker calls for fiscal support in the fight against inflation," the *Financial Times* says.

"The only alternative we see is *higher* taxes."

Willard Butcher, president of the Chase Manhattan Bank, told the Union League Club of New York this week that indeed Mr. Reagan must adopt a Thatcher-style fiscal program. "No central bank can wring out inflation when, at the same time, the federal government continues to finance large deficits," he said. "The U.S. must not abandon sound monetary policy," "but add to it cuts in "government spending and borrowing."

Mr. Butcher also proposed to phase out the cost-of-living clause in most U.S. labor contracts.

Benjamin Rowland, of New York's Salomon Brothers investment bank told *EIR* that a January dollar crisis "is baked into the cake" by Volcker's interest rate policy. "The dollar is very weak on fundamentals, the economy is weak. Volcker's raising of rates has served to mask this, while weakening the economy, by attracting short-term money into the dollar. But it's only international hot money, flight capital.

"Volcker has also baked a new recession into the cake, and when it hits and interest rates fall, all the hot money will go right out of the dollar. Rates don't even have to fall sharply. One or two percent will do it," he stated.

"To defend the dollar, Reagan will have to eliminate all his other policies," Rowland stated, "eliminate tax cuts, and go with deep budget cuts."

Reagan, however, does have a choice: he should dump both the Volcker and Thatcher budget program. Sources close to the President-elect say he may do just this, and go with a program of credit for industrial capital formation which will make the dollar look very good indeed.